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May 17, 2011

URGENT REGULATORY MATTER

Mary L. Schapiro
Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-2736

Gary Gensler
Chairman
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Proposed SEC Rule 240.21F-8 and CFTC Rule RIN number 3038-AD04, for Implementing Whistleblower Provisions of the Dodd-Frank Act

RESPONSE TO FIRST COURT DECISION ON DODD-FRANK WHISTLEBLOWER PROTECTIONS

Dear Chairman Schapiro and Chairman Gensler:

On May 4, 2011 the United States District Court for the Southern District of New York issued the first reported decision under the Dodd-Frank Act's whistleblower protection provisions. *See, Egan v. Tradingscreen*, 2011 WL 1672066 (S.D.N.Y.). This decision raises significant regulatory issues that have a direct impact on the Dodd-Frank rulemaking proceedings currently ongoing within the Securities and Exchange Commission ("SEC") and the Commodity Futures Trading Commission ("CFTC").

This letter is filed as an official rulemaking comment by the National Whistleblowers Center. Although the letter is filed after the close of the formal rulemaking comment period, given the timing of the court's decision in *Egan,* good cause exists for considering this letter as timely filed.

The *Egan* decision concerns a major issue addressed as part of the Dodd-Frank whistleblower rulemaking proceedings: the integrity of corporate internal compliance and reporting programs. In *Egan* the employee had contacted the President of his employer, and had contacted members of the company's Board of Directors in order to report fraud. The Board retained an outside law firm (Latham and Watkins) to investigate the fraud allegations. The allegations were proven to be correct. However, the whistleblower was fired. The issue presented to the Court in *Egan* was whether or not the employee engaged in protected activity when he utilized the internal reporting processes permitted by his employer. The employee argued that internal reports were protected

under Section 21F of the Dodd-Frank Act, 15 U.S.C. § 78u-6(h). The employer argued that internal reports were *not* protected, and that employees who failed to directly report allegations of fraud to the SEC could be fired at will, and that the Dodd-Frank Act did not protect such reports.

In short, the employer in this case presented legal argument that would have the direct effect of undermining internal corporate compliance programs. If employees *must* file their fraud allegations directly to the SEC in order to ensure protection under Dodd-Frank's anti-retaliation provisions, important policy objectives identified by the SEC and the CFTC during the Dodd-Frank rulemaking proceeding would be seriously undermined.

In order for the Commissions to ensure that employees can utilize internal reporting programs, and are not required to contact the SEC or CFTC in order to obtain protection against being fired, the Commissions must address the issue raised in *Egan* and ensure that future court decisions properly hold that employee utilization of internal reporting procedures are fully protected under law.

The district court in *Egan* correctly interpreted the plain meaning of the Sarbanes-Oxley Act, the federal Obstruction of Justice Act and the Dodd-Frank Act as protecting employees who raised concerns directly with federal law enforcement agencies, the Securities and Exchange Commission and Congress. These three statutes unquestionably protect such disclosures. The right of employees to contact federal law enforcement, a Congressional and regulatory agency is beyond dispute. However, the right of employees to contact their internal compliance programs, their Boards of Directors is not so clear. Since 1984-85 the U.S. Courts of Appeal have not agreed on the scope of so-called "internal" protected activity. *Compare*, *Brown & Root v. Donovan*, 747 F.2d 1029 (5th Cir. 1984) (requiring whistleblowers to contact a "competent organ of government" in order to be protected) with *Kansas Gas & Electric Co. v. Brock*, 780 F.2d 1505 (10th Cir. 1985) (internal quality control complaints protected). A critical factor in understanding why the Courts differed in *Brown & Root* and *Kansas Gas & Electric* was the role played by the responsible federal regulatory agency (in these cases, the Nuclear Regulatory Commission or "NRC").

In *Brown & Root* the responsible federal regulatory agency did not weigh in on the issue of whether or not complaints to internal compliance programs should be protected. However, because of the potentially destructive impact the *Brown & Root* ruling would have on existing internal compliance programs, the NRC participated as an *amicus curiae* in that case, and explained to the Court the NRC's existing regulations, and how these regulations mandated the necessity of protecting internal whistleblowers. Significantly, while the appeals court fully understood that the NRC did not have "jurisdiction" over the anti-retaliation provisions of the Energy Reorganization Act, *see* 780 F.2d at 1509 ("jurisdiction over employment matters resides with the Secretary of Labor" and "the NRC is not free to accept jurisdiction over these matters"), the court nonetheless gave "great weight" to the NRC's regulations, and endorsed the NRC's "broad reading" of the scope of protected activity. *See*, 780 F.2d at 1512.

Just as the NRC weighed in, and ensured that its regulatory structure would protect whistleblowers who worked directly with internal compliance programs, it is now clearly necessary for the SEC and CFTC to likewise weigh in on this issue. In fact, the district court in *Egan* all but asked the Commissions to address this issue and provide guidance on the Commission's views on whether or not internal employee reporting should be considered a protected activity. *Egan v. Tradingscreen*, 2011 WL 1672066, p. 8 (S.D.N.Y.).

The *Egan* court, citing to clear judicial precedent, noted that the Commission's final rule as to whether or not employees who raise concerns within their corporations should be entitled to protection under the anti-retaliation provisions on the Dodd-Frank whistleblower provisions would be entitled to "considerable weight" by courts seeking to interpret this law. *Egan v. Tradingscreen*, 2011 WL 1672066, p. 8 (S.D.N.Y.). The court noted that the SEC had not specifically commented on whether or not employees who utilize internal reporting programs are protected and thus, the court was not in any position to rely upon the SEC's guidance on this matter:

> *[The SEC] has not spoken on the precise question involved in this case . . . . In sum, the SEC has not decided whether it will issue regulations implementing those provisions of the Dodd-Frank Act at issue here. Therefore, it has proposed no interpretation of the statute requiring deference from this Court in this case.*

Id., p. 8.

Based on the public statements of the Commissions, it is clear that the Commissions believe that employees who raise concerns internally with their management/compliance programs/Board of Directors/Audit Committees, should be protected. The regulated community, although silent as to the scope of protected activity under the Sarbanes-Oxley Act, the Obstruction of Justice Act and the Dodd-Frank Act, have clearly endorsed internal compliance programs, and have expressed an opinion that such programs can serve the public interest and help further a corporate culture that rewards honesty and respect for the law. Thus, it would be inconsistent for employers to oppose Commission rules that firmly and unequivocally prohibit them from retaliating against internal whistleblowers. Likewise, it would be inconsistent for the organizations not to join with the National Whistleblowers Center and endorse strong regulations that strictly prohibit any form of retaliation against employees who aggressively perform compliance functions within a corporation, including auditors, investigators, employees who manage hotlines, and Chief Compliance Officers. Similarly, corporations should not be able to terminate contracts with third-party vendors who provide outsourced compliance services, simply because these outsourced services aggressively investigate employee concerns, adhere to strict confidentiality rules and/or issue findings that may harm a company's short-term profits.

A counter-interpretation of the anti-retaliation laws would have a devastating impact on the Commissions' goal of promoting internal compliance in appropriate circumstances. Under the current interpretation rendered by the *Egan* court, employees have no choice but to bypass internal reporting systems and directly raise concerns regarding violations of securities laws with federal regulatory agencies and the Justice Department. Under the *Egan* court's holding, without

such contacts employees could be fired. Under *Egan*, the purported "fear" expressed by many in the regulated community that monetary incentives would induce employees to bypass internal reporting systems would simply be irrelevant. If employees can be fired for using internal systems, organizations, such as the National Whistleblowers Center and the numerous attorneys who work with us, will do everything it their power to ensure that employees bypass such channels, as anything else could constitute malpractice. It would be the height of irresponsibility for whistleblower advocates to urge employees to use internal reporting programs, if there was any risk that such contacts would be ruled non-protected, resulting in employee terminations and blacklisting.

The *Egan* court invited the Commissions to address this issue. The CFTC and the SEC should follow the precedent set by the NRC and issue formal rules that establish the Commissions' respective position that employees who contact internal compliance programs should be afforded equal protection to employees who contact governmental agencies. Furthermore, the Commissions' rules should strongly endorse a position that employees who perform compliance functions -- from the Chief Compliance Officer to a line-auditor -- are fully protected if they perform their jobs aggressively, and report or uncover violations. *See Mackowiak v. University Nuclear Systems*, 735 F.2d 1159 (9th Cir. 1984) (protecting company inspectors who aggressively performed their jobs and identified potential violations).

Thank you in advance for your prompt and careful attention to this letter.

Respectfully submitted,

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